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IN THE

UNITED STATES CIRCUIT COURT OF APPEALS

FOR THE NINTH CIRCUIT.

No. 10292

BABOQUIVARI CATTLE COMPANY, *Petitioner,*

v.

COMMISSIONER OF INTERNAL REVENUE, *Respondent.*

PETITIONER'S BRIEF.

Upon Petition to Review a Decision of the Tax Court of the United States.

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PETITIONER'S BRIEF.

JURISDICTIONAL STATEMENT.

Petitioner is a corporation organized and existing under the laws of the State of Arizona, and during 1937 and 1938 was engaged in the operation of a cattle ranch known as the Santa Margarita Ranch, located in the Southwest portion of Pima County, Arizona. (R. 19) It filed its Federal income and excess profits tax returns for those years with the Collector of Internal Revenue for the District of Arizona. (R. 19) The respondent, hereinafter referred to as the Commissioner, is the duly appointed, qualified and acting Commissioner of Internal Revenue of the United States, holding his office by virtue of the laws of the United States.

The controversy involves the proper determination of

the Federal income tax liability of petitioner for the calendar years 1937 and 1938. In a deficiency notice dated April 20, 1940, the Commissioner determined deficiencies in income taxes of petitioner for such years in the aggregate amount of $1,220.06. (R. 4, 11, 13) From such determination petitioner duly prosecuted an appeal to The Tax Court of the United States.* (R. 4-11) On June 16, 1942, the Tax Court promulgated its opinion sustaining the Commissioner's determination, and on the same day entered its decision determining deficiencies in petitioner's income taxes for the years 1937 and 1938 in the respective amounts of $795.60 and $424.46. (R. 29-50)

Thereafter, on September 14, 1942, petitioner filed its Petition for Review (R. 51-57), seeking a review of the Tax Court's decision by this Court, pursuant to the provisions of Sec. 1142 of the Internal Revenue Code. (53 Stat. 1) This Court has jurisdiction of the proceeding by virtue of the provisions of Sec. 1141 of the Internal Revenue Code (53 Stat. 1), the returns of tax, in respect of which the Commissioner determined the contested deficiencies, having been filed in the office of the Collector of Internal Revenue for the State of Arizona.

Statutes and Regulations Involved.

Sec. 22 of the Revenue Acts of 1936 (49 Stat. 1648) and 1938 (52 Stat. 447) provides in part as follows:

> "(a) General Definition.—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service, of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the

* This tribunal was then known as the United States Board of Tax Appeals. Its official name was changed to The Tax Court of The United States by Title V, Sec. 504, of the Revenue Act of 1942, amending Sec. 1100, I. R. C., and, for purposes of convenience, it will be referred to throughout this brief as the Tax Court.

transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever.

* * *

(b) EXCLUSIONS FROM GROSS INCOME.—The following items shall not be included in gross income and shall be exempt from taxation under this title:

* * *

(3) GIFTS, BEQUESTS AND DEVISES.—The value of property acquired by gift, bequest, devise, or inheritance (but the income from such property shall be included in gross income); * * *."

Relevant provisions of the Soil Conservation and Domestic Allotment Act (H. R. 7054, Public No. 46, 74th Cong., approved April 27, 1935, 49 Stat. 163, as amended by S. 3780, Public No. 461, 74th Cong., approved Feb. 29, 1936, 49 Stat. 1151) are set forth in Appendix "A" hereto. Pursuant thereto the Department of Agriculture promulgated regulations entitled "1937 Agricultural Conservation Program-Western Region, Bulletin No. 101—Arizona," issued on January 14, 1937, and published in the Federal Register, Vol. 2, No. 38, page 435, as amended by a supplement issued June 3, 1937, and published in the Federal Register, Vol. 2, No. 108, page 1141, and further amended by a supplement issued July 23, 1937, and published in the Federal Register, Vol. 2, No. 143, page 1554.

QUESTION INVOLVED.

Where a participant in approved range-building practices under the Federal Range Conservation Programs, as provided for in the Soil Conservation and Domestic Allotment Act, receives sums of money from the United States as reimbursement for expenditures made by the participant, in pursuance of such approved programs, are such sums includible in the taxable income of the participant?

Statement of the Case.

At no time has there been any controversy regarding the material facts in this proceeding. (R. 29) The case was submitted to the Tax Court upon a stipulation signed by the parties, (R. 19-21) certain documentary exhibits, (some of which were deemed immaterial by the parties for the purposes of this appeal and were therefore omitted from the Record), and the affidavit of Mr. Carlos E. Ronstadt, petitioner's President, (R. 22-28). The parties stipulated that this affidavit might be received in evidence with like effect as though Mr. Ronstadt personally appeared and testified to the matters set forth therein. (R. 21) In addition, certain material facts pleaded in the petition were admitted in the Commissioner's answer. (R. 17-18)

In his deficiency notice dated April 20, 1940, the Commissioner determined alleged deficiencies of $795.60 for 1937 and $424.26 for 1938. (R. 11-17) These deficiencies result solely from the inclusion in petitioner's taxable income of amounts received by it from the United States as payment for approved projects constructed by petitioner pursuant to the Soil Conservation and Domestic Allotment Act. (R. 14, 16, 21, 29)

Petitioner's cattle ranch comprises approximately 57,200 acres of land located in the southwest portion of Pima County, Arizona. (R. 19, 30) Of the total acreage comprising this ranch, 7,319 acres were owned outright by the petitioner; 45,880 acres were owned by the State of Arizona and held by petitioner pursuant to certain grazing leases executed by petitioner and the State Land Department of the State of Arizona, in accordance with the laws of that state, each lease covering a specified parcel of land and providing for a term of five years (R. 19-20, 30); and 4,000 acres were owned by the United States and were held by petitioner pursuant to the provisions of the Taylor Grazing Act of June 28, 1934 (48 Stat. 1269), as amended. (R. 19-20, 30)

Petitioner's ranch is located in a hot, semi-arid region, most of the rainfall occurring during the three summer

months. It is situated on the water shed of the Gila River, a tributary of the Colorado River. Due to climactic and geographic conditions, lands in this region are subject to substantial erosion. (R. 5, 18, 30)

In the summer of 1937, a range grazing examiner, working in conjunction with the Pima County Range Conservation Committee established under the Soil Conservation Program, had made a survey of petitioner's ranch, and issued a report recommending that certain improvements be made thereon. (R. 30) This report was approved by the Committee on or about July 16, 1937, and pursuant to such authorization and the instructions contained therein, the petitioner constructed or rebuilt on its ranch a series of dirt reservoirs and earthen tanks, constructed a rubble masonry dam, built more than two miles of drift fence, deepened a well, and developed a spring or seep. (R. 30)

Upon the completion of a portion of this work in 1937, an application for reimbursement was filed by petitioner and approved by the Committee. (R. 20, 25, 31) Payment was authorized and made to petitioner during 1937 in the amount of $3,586.89, this sum having been computed in accordance with the regulations issued under the Soil Conservation and Domestic Allotment Act. (R. 20, 25, 31)

Upon completion of the remainder of the authorized work in 1938, payment was made in the amount of $3,247.74. (R. 20, 27, 31) The amounts so received by petitioner were only approved for payment after inspection by Government officials and after careful measurement by them of the quantities of fill or excavation and the number of feet of fence, said payments being arrived at by allowing the amount per cubic yard prescribed by the regulation, or the amounts allowed per rod for fence construction. See "1937 Agricultural Conservation Program—Western Region, Bulletin No. 101—Arizona," *supra.* (R. 28)

The cost to it of the construction work so done by petitioner in each of the years 1937 and 1938 exceeded the amounts which it received in each of such years from the United States as hereinbefore set forth. (R. 28, 31) In

the petitioner's books of account, kept on an accrual basis (R. 29), the cost of the above improvements was not charged to Profit and Loss, but rather was treated as a capital item and carried into an asset account, entitled "Improvements Under Federal Aid." (R. 20, 31-32) The amounts received from the United States as reimbursement were then treated as a credit to Capital Surplus. (R. 20, 32)

In its returns of income such amounts were shown as carried upon petitioner's books, but neither was included in its gross income. (R. 32) The Commissioner added each of them to the net taxable income reported. (R. 14, 16, 32)

Specification of Errors.

The petitioner asserts that in the proceedings before The Tax Court, and in the opinion and decision entered by it, errors occurred to the prejudice of petitioner, and it asserts and assigns the following errors and points upon which it relies:

(1) The Tax Court erred in holding that the payments of $3,586.89 and $3,247.74 made to petitioner by the United States during the years 1937 and 1938, respectively, as a result of petitioner's participation in approved range building practices under the Soil Conservation and Domestic Allotment Act, were income to petitioner.

(2) The Tax Court erred in failing to hold that the payments so made to petitioner represented reimbursements to petitioner for capital expenditures made by it, and thus should be considered as non-taxable contributions to petitioner's capital assets.

(3) The Tax Court erred in failing to hold that the taxation of such payments to petitioner as income would serve to reduce the benefits granted by the Soil Conservation and Domestic Allotment Act, *supra,* thus serving to defeat the very purpose of Congress.

(4) The Tax Court erred in failing to hold that such payments constituted gifts to petitioner, and were therefore exempt from taxation under Section 22 (b) (3) of the Revenue Acts of 1936 and 1938, *supra.*

(5) The Tax Court erred in holding and deciding that there are deficiencies in petitioner's income taxes for the years 1937 and 1938 in the respective amounts of $795.60 and $424.46.

Summary of Argument

I. The taxation of the payments or grants to petitioner would *pro tanto* reduce the subsidies granted by the Soil Conservation and Domestic Allotment Act, and thus serve to defeat the very purpose of Congress; and the presumption is against their taxability.

II. It was error on the part of the Tax Court to ignore the subsidizing nature of these grants and to hold and to stress them to be "benefit" payments.

III. The payments do not constitute taxable income within the meaning of the Sixteenth Amendment, being mere contributions to the recipient's capital assets.

1. The tax Court erred in failing to hold that the principle of *Edwards* v. *Cuba Railroad Co.,* 268 U. S. 628, controls this case, and in omitting to find that no material feature of this case serves to distinguish it from that case.

2. The principle enunciated by the Supreme Court in *Edwards* v. *Cuba Railroad Co., supra,* has been followed time and again by the Circuit Courts of Appeals and the Tax Court.

3. No case cited by the Tax Court serves to invalidate the contentions of petitioner in this case.

4. It was error to hold that the payments here involved are taxable on the assumption that wholly different classes of payments under the same act may be taxable.

IV. It was error to support the Tax Court's conclusion by considering the effect of an uncontested depreciation deduction in respect of the range improvements.

V. The grants may be construed to be gifts to petitioner, and therefore exempt from taxation under Sec. 22(b)(3).

ARGUMENT.

I. The taxation of the payments or grants to petitioner would pro tanto reduce the subsidies granted by the Soil Conservation and Domestic Allotment Act, and thus serve to defeat the very purpose of Congress; and the presumption is against their taxability.

There is a very practical reason for not regarding the payments as taxable. If taxed, then to the extent of the tax the recipient's payments are thereby reduced. It is hardly to be presumed that Congress intended to recapture or retake part of the very sums it appropriated to accomplish the specific purposes of the Soil Conservation and Domestic Allotment Act. There is certainly no language in that Act that even suggests that the payments or grants shall be subject to an income tax.

In the region in which petitioner's ranch is located, soil erosion has resulted in great part because of over-grazing of land, resulting in the elimination of vegetation, which would normally hold the soil in place during the heavy rains which are usually concentrated in the summer months of the year. For many years neither the Federal Government nor the State of Arizona promoted soil conservation programs, nor did they provide restrictions on grazing upon the public lands. The range programs adopted in recent years have tended to eliminate over-concentration of grazing, but it will take many years and a carefully-planned program of soil erosion control to rebuild the ranges depleted and eroded through lack of foresight and planning in former years. The construction of earthen reservoirs and diversion dikes in connection therewith, and the construction of

rubble masonry dams in mountainous areas make available additional permanent supplies of water for stock, thereby spreading the grazing livestock over a larger area and maintaining a more constant ground covering, which is a decided factor in the prevention of soil erosion by rapid run-off of water. Such construction also retards the flow of water and allows uplands to absorb more moisture, thereby serving the two-fold purpose of preventing erosion in the lowlands and the spreading of livestock in the uplands. (R. 27.)

It should be unnecessary to submit arguments that Congress intended by the soil conservation provisions primarily to conserve and protect the natural resources of the United States for the general public welfare, rather than to provide for a profit or gain to an individual citizen. The purposes of the legislation are not only set forth in the title and preamble to the Act of April 27, 1935, (Appendix "A" hereto) but are considered at great length in the Committee Reports to Congress in connection with H. R. 7054 and S. 3780. For the convenience of the Court, we have set forth in Appendix B hereto several rather lengthy quotations from those reports, which establish beyond doubt the intent of Congress in enacting the laws under which the payments were made to petitioner.

In the instant case, the evidence shows that petitioner expended more for the soil conservation projects it carried out than the amounts reimbursed to it. (R. 28, 31) Most of these projects were on land leased from the State of Arizona. (R. 20, 32) However, the improvement inured not only to the benefit of petitioner's ranch, but to the benefit of lands in the same range or region. (R. 28) In Senate Report No. 466 (Appendix "B" hereto) it was pointed out—

> "For the Nation, land destroyed is land gone forever. This drain on the national resources is not immediately fatal, but, if the destruction continues unchecked, the time will come when remaining land resources will be insufficient to support our population on an adequate standard of living. The cost to the Nation of such changes would be incalculable. Moreover, erosion di-

> rectly threatens vast Federal investments in dams and channels, and annually requires the expenditure of large sums for dredging operations. *The only practical method of eliminating these hazards and costs is to control the erosion on private lands, and it would not be equitable to require the owner of these lands to make expenditures for the protection of Federal investments.''* (Italics supplied)

It would be a strange anomaly to hold that, while, on the one hand, Congress appropriated funds to carry out erosion control and encourage conservation, on the other hand and at the same time, it intended to recapture, through the income tax, a portion of grants made for that purpose. That Congress had a contrary intent is clear. In Senate Report No. 1481 (Appendix ''B'' hereto) it was said:

> ''Thus, the bill lays out a plan for an ordered program designed to encourage sound soil conservation practices *without thereby diminishing farmers' incomes* or causing undue curtailment of supplies of agricultural commodities.''

The practical effect of the Tax Court's decision herein is to reduce the amount of the 1937 grant to petitioner of $3,586.89 by the tax thereon of $795.60, and to reduce the 1938 grant of $3,247.74 by the tax thereon of $424.46. These taxes must be paid out of petitioner's ordinary operating income. The full amounts received from the Government (and more) were expended for the range improvement projects constructed by petitioner. *Nothing was left over for taxes.*

As a price for its cooperation in the Government's soil conservation program, the Tax Court holds petitioner liable for these taxes. Such a holding surely serves to defeat the *express* Congressional intent of encouraging soil conservation ''without thereby diminishing farmers' income.'' Clearly, therefore, to tax the payments is to defeat the very purposes of the Soil Conservation and Domestic Allotment Act, and to reduce the sums available to the recipient with

which to carry out the desired conservation program. This argues strongly that the payments were never intended by Congress to be subjected to taxation as income.

The decision in this case, therefore, should be approached from the standpoint that the grants received by petitioner should not be taxed unless there be some provision in the tax laws that will permit no other conclusion. Neither the Tax Court nor respondent can or has pointed to such provision.

In this connection, it must be remembered that no tax can be imposed by implication, or by judicial construction. Tax statutes must be strictly interpreted against the Government, and all doubts resolved in favor of the taxpayer. *Gould* v. *Gould,* 245 U. S. 151; *Crooks* v. *Harrelson,* 282 U. S. 55; *Cole* v. *Commissioner,* 81 Fed. (2d) 485; *Commissioner* v. *Bryn Mawr Trust,* 87 Fed. (2d) 607, 611. This is a "salutary policy." *In re Owl Drug Company,* (1937) (CCH Tax Service, Paragraph 9466). The Tax Court cited *Pacific Company, Ltd.* v. *Johnson,* 285 U. S. 480, *Sun-Herald Corp.* v. *Duggan,* 73 Fed. (2d) 298, and *U. S.* v. *Steward,* 311 U. S. 60, to support its conclusion that Congress intended to tax these payments, but none of them is in point. For the purposes of the present discussion, those cases simply hold that an *exemption section* of a taxing statute is to be construed strictly and doubt resolved in favor of the taxing power. That is far from saying that a tax may be imposed by implication, or judicial construction, where, as here, there is *no provision* in the tax laws or other applicable statutes specifically levying a tax on the amounts in question or otherwise pertaining thereto. In such a case, any doubt is to be resolved in favor of the taxpayer. See *Gould* v. *Gould, supra.*

The general rule may be conceded that exemptions are never granted on inference alone. However, as the Supreme Court has pointed out, this does not mean that the rule should be so grudgingly construed as to thwart the legislative purpose. *Trotter* v. *Tennessee,* 290 U. S. 354, 356. See *Bankers Trust Company et al, Executors* v. *Comm.,* 33 B. T.

A. 746. The rule is discussed and the correct distinction pointed out in Mertens, *"Law of Federal Income Taxation"* (1942), Section 3.07. That learned author states:

> "When public policy dictates a more liberal attitude, as with bequests for public purposes *and the performing by private means of what would ultimately entail public expense,* the Courts will not follow this general rule. Such an exemption is an act of public justice, not a matter of grace and favor . . . " (Italics supplied)

The many evidences of congressional intention in this case make pertinent a statement by the late Mr. Justice Holmes in "The Common Law", page 303 (1881). He said:

> "The very office of construction is to work out, from what is expressly said and done, what would have been said with regard to events not definitely before the minds of the parties, if those events had been considered."

It seems clear that this is a case where the Court should presume against the taxability of the receipts. In such a holding this Court would be supported both by the practical aspects of the soil conservation legislation and by the rules of construction applicable to tax laws.

II. It was error on the part of the Tax Court to ignore the subsidizing nature of these grants and to hold and to stress them to be "benefit" payments.

Although the point is never expressly made, it is implicit in the Tax Court's opinion that it does not consider the grants made to petitioner as subsidies. For example, the Tax Court says, in its opinion (R. 40-41):

> "Notwithstanding the stipulation of the parties to the effect that the payments were 'reimbursement or payments for improvements made on land owned outright by petitioner . . . or by the State of Arizona', we feel that they were nothing but benefit payments for carrying out approved range improvement practices recommended by the range examiner and approved by the

> county conservation committee. . . . Our question is essentially whether the benefit payments are income to the recipient. . . . ''

By thus phrasing the question, the Tax Court's answer is made to appear a plausible one. It must be pointed out, however, that the problem here cannot be answered by merely calling the amounts ''benefit payments''. *The Soil Conservation and Domestic Allotment Act does not so denominate them.* It simply refers to the payments as ''payments or grants'' of aid. See Section 8 of the Act. When reference is made to the usual meaning of those words, petitioner believes it to be self-evident that these amounts partake more of the nature of subsidies than that of benefits.

For example ''subsidy'' is defined in Webster's New International Dictionary (2nd edition) as follows:

> ''*Subsidy.* 1. aid; assistance; any gift of money or property made by one person to another by way of financial aid. . . . 3. A grant of funds or property from a Government . . . to a private person or company to assist in the establishment or support of an enterprise deemed advantageous to the public; a subvention.''

''*Benefit*'', on the other hand, is defined by the same authority thus:

> ''*Benefit.* 1. A good deed. 2. Act of kindness; favor conferred; gift; benefaction. 3. Whatever promotes welfare; advantage; profit. 4. Specif. (a) pecuniary advantage or profit.''

It needs little argument to support the contention of petitioner that these payments are more in the nature of a ''grant of funds . . . from a Government . . . to a . . . . company to assist in the establishment or support of an enterprise deemed advantageous to the public'' rather than ''a good deed'' or ''act of kindness.'' Certainly no ''pecuniary advantage or profit'' has accrued to petitioner, since the Tax Court found as a fact that ''the cost of the

work in each year exceeded the amount received by petitioner from the United States." (R. 31) Clearly, these payments were but part of a vast and nation-wide undertaking by the United States Government to induce by subsidization a cooperative effort by farmers and ranchers to save the land of the nation from erosion and ultimate destruction. No clearer case of a subsidy is, or can be, suggested.

It is certainly as clear a case of subsidy as that involved in *Seas Shipping Company, Inc.* v. *Comm.*, 1 T. C. No.7. In that case, the petitioner shipping company entered into an "operating differential subsidy contract" with the United States Maritime Commission under which it was obligated to pay a certain proportion of its earnings into a "capital reserve fund." It was held, pursuant to the Merchant Marine Act of 1936, that the earnings so deposited by the taxpayer during the year 1938 were exempt from income taxes. Due to the provisions of the statute there involved, the holding of the Tax Court is not in point here, but certain portions of its language used in discussing the nature of the subsidy in that case are of assistance in determining the nature of the subsidy made by the Government in this case. The Tax Court says, on page 10 of its opinion, that:

> "By the Merchant Marine Act, as we have seen, Congress was principally concerned in building up a merchant marine. The Act was not primarily for the benefit of the operator. It was for the benefit of the United States. The Congress was interested in having a large and up-to-date merchant marine which could be availed of in case of war or national emergency."

Similarly, in this case, the Congress, by its passage of the Soil Conservation and Domestic Allotment Act, was principally concerned in preventing soil erosion and destruction of the Nation's land resources. That Act was not primarily for the benefit of the "operator"; it was clearly for the benefit of the United States. It was a clear case of subsidization.

Keeping in mind, then, that the payments made to petitioner in this case are subsidies in the purest sense, we proceed to a discussion of *Edwards* v. *Cuba Railroad Company,* 268 U. S. 628 (1925), a decision by the Supreme Court which petitioner contends rules this case in all respects.

III. The payments do not constitute taxable income within the meaning of the Sixteenth Amendment, being mere contributions to the recipient's capital assets.

1. *The Tax Court erred in failing to hold that the principle of Edwards* v. *Cuba Railroad Co., 268 U. S. 628, controls this case, and in omitting to find that no material feature of this case serves to distinguish it from that case.*

With all due respect and deference to the Tax Court, counsel for petitioner feel constrained, after a careful analysis of the Tax Court's opinion, to point out that in this case it has, perhaps unconsciously, refused to follow a decision of the Supreme Court of the United States, which it does not attempt to distinguish.

It is submitted that the principle of *Edwards* v. *Cuba Railroad Co., supra,* is here controlling. While the Tax Court holds such case is not controlling, it makes no attempt to distinguish the facts in the case. The only analysis of the *Cuba Railroad* case appears at page 8 of the opinion (R. 43-44), where it is stated that—

> "The briefs of the parties are largely devoted to a discussion of the rules enunciated by the Supreme Court in *Edwards* v. *Cuba Railroad Co.,* 268 U. S. 628, and its applicability to the stipulated facts. Stated generally, it is that a contribution to the capital assets of a railroad company in order to induce construction and operation of railroads for the service of the public, does not constitute income to the recipient within the meaning of the Sixteenth Amendment. The cited case has been followed many times by the Courts and this Board."

This is followed by a reference to cases where the *Cuba Railroad* case was followed (all of which seem in point), and then by a reference to other cases where the *Cuba Railroad* case was distinguished on the facts (all of which cases are readily distinguished from the facts in this case). However, at no point are the material facts in this case shown to differ from the material facts in the *Cuba Railroad* case. In that case, money subsidies were granted by the Cuban Government to an American railroad company to promote the construction of railroads in Cuba, and in consideration, also, of reduced rates to the public as well as reduced rates and other privileges for the Cuban Government. The subsidies were fixed and paid proportionately to mileage actually constructed, and were used for capital expenditures by the company, although not entered on its books as in reduction of the cost of construction. In holding that the payments could not be taxed as income, the Supreme Court said:

> "The Sixteenth Amendment, like other laws authorizing or imposing taxes, is to be taken as written and is not to be extended beyond the meaning clearly indicated by the language used. The Cuban laws and contracts are similar to legislation and arrangements for the promotion of railroad construction which have been well known in the United States for more than half a century. Such aids, gifts and grants from the government, subordinate political subdivisions or private sources,—whether of land, other property, credit or money,—in order to induce construction and operation of railroads for the service of the public are not given as mere gratuities. Burke v. Southern Pacific R. R. Co., 234 U. S. 669, 679; Louisville & Nashville R. R. v. United States, 267 U. S. 395. Usually they are given to promote settlement and to provide for the development of the resources in the territory to be served. The things so sought to be attained in the public interest are numerous and varied. There is no support for the view that the Cuban Government gave the subsidy payments, lands, buildings, railroad construction and equipment merely to obtain the specified concessions in respect of rates for government trans-

portation. Other rates were considered. By the first contract, plaintiff agreed to reduce fares for first class passengers and by the second, it agreed to reduce the rates on small produce. Clearly, the value of the lands and other physical property handed over to aid plaintiff in the completion of the railroad from Casilda to Placetas del Sur was not taxable income. These were to be used directly to complete the undertaking. The Commissioner of Internal Revenue in levying the tax did not include their value as income, and defendant does not claim that it was income. *Relying on the contract for partial reimbursement, plaintiff found the money necessary to construct the railroad. The subsidy payments were proportionate to mileage completed; and this indicates a purpose to reimburse plaintiff for capital expenditures.* All—the physical properties and the money subsidies—were given for the same purposes. It cannot reasonably be held that one was contribution to capital assets, and that the other was profit, gain or income. Neither the laws nor the contracts indicate that the money subsidies were to be used for the payment of dividends, interest or anything else properly chargeable to or payable out of earnings or income. *The subsidy payments taxed were not made for services rendered or to be rendered. They were not profits or gains from the use or operation of the railroad, and do not constitute income within the meaning of the Sixteenth Amendment.''* (Italics supplied)

Considering the purposes of the Soil Conservation and Domestic Allotment Act and the uses to which the payments thereunder are to be applied by the recipients, it seems clear that this case is squarely ruled by the Supreme Court's opinion in the *Cuba Railroad* case. Here, as in that case, the payments constitute a ''contribution to capital assets''; and there is a ''purpose to reimburse * * * for capital expenditures.'' Also here, as in that case, there is no indication that the subsidies are ''to be used for the payment of dividends, interest or anything else properly chargeable to or payable out of earnings or income,'' and furthermore, the payments are ''not made for services rendered or to be rendered.''

For purposes of emphasis petitioner believes that the use of a comparative columnar analysis will serve to demonstrate further that the instant case is on all fours with the *Cuba Railroad* case.

*Cuba Railroad Co.**	*Baboquivari Cattle Company*
By an act of its Congress the Cuban government was authorized to contract with one or more railroad companies for construction and operation of certain lines of railroad on designated routes and between places specified by the government.	By an act of Congress the Secretary of Agriculture was authorized to make "payments or grants" of aid to any agricultural producers carrying out approved land preservation practices.
After the completion of one line the Cuban government paid the Cuba R. R. Co. at the rate of $5000 per kilometer in six annual installments. On another line Cuba R. R. Co. received $6000 per kilometer paid in six annual installments as the work progressed.	After the completion of specified and approved conservation practices in 1937, Baboquivari was paid $3,586.89 by the U. S. government, computed on the basis** of the quantities of material furnished and work done. In the year 1938 Baboquivari was paid $3,-247.74 on approval of the specified construction, computed on a similar basis.
In consideration of such reimbursement, Cuba R. R. Co. reduced its rates and accorded other privileges to the Cuban government.	In consideration of such grants the U. S. Government was the recipient of land erosion controls protecting its surrounding land resources.

* The findings of fact by the lower court (Augustus N. Hand, D. J.) should also be examined for completeness. See *Cuba R. R. Co.* v. *Edwards*, 298 Fed. 664 (D. Ct. S. D. N. Y.) (1921).

** In this connection it is to be observed that range building allowances, established upon considerations of size of range, grazing capacity, etc., did not measure the payments to be made, but merely served to apportion the available appropriation and set the maximum sum available to any given ranch. The actual payments were based upon the quantities of materials and work actually furnished; *e. g.*, 15¢ per cubic yard for excavation, 30¢ per rod for fences, etc. (R. 28; Fed. Reg., Vol. 2, No. 38, p. 438)

The amounts paid to Cuba R. R. Co. by the Cuban government did not equal the cost of the specified lines.	The amounts paid to Baboquivari did not equal the cost of the specified land-preservation structures.
Relying on the contract for partial reimbursement, plaintiff found the money necessary to construct the railroad.	Relying on the official designation of the projects for which payment would be made and the statutory provisions for reimbursement, petitioner found the necessary money to construct the projects.
The subsidy payments were proportionate to mileage completed.	The subsidy payments were proportionate to excavation completed, fences constructed, etc.
All payments so made were credited by Cuba R. R. Co. to a suspense account, later transferred to surplus account, and were used for capital expenditures.	The cost of the land improvements made by Baboquivari was not charged to profit and loss, but was treated as a capital item and carried into an asset account.
Nothing in the laws or contracts indicated that the payments might be used for payment of dividends, interest or anything else properly chargeable to or payable out of earnings or income.	There is nothing to indicate that the payments might be used to pay anything properly chargeable to or payable out of earnings or income.

From this comparison of the two cases, it is apparent that no controlling differences between them may be found. In each instance there is present the clear purpose "to reimburse plaintiff for capital expenditures." In this connection, it should be noted that the Tax Court found as a fact that—

> "In petitioner's books of account the cost of the improvements was not charged to profit and loss, but was

> treated as a capital item and carried into an asset account, entitled 'Improvements under Federal Aid.' The amounts received by petitioner in the taxable years were treated as credits to capital surplus." (R. 31-32)

This finding constitutes a clear showing that the payments in question were received, treated and used by petitioner as reimbursement for its capital expenditures.

2. *The principle enunciated by the Supreme Court in Edwards* v. *Cuba Railroad Co., supra, has been followed time and again by the Circuit Courts of Appeals and the Tax Court.*

The doctrine announced by the Supreme Court in the *Cuba Railroad* case has been applied to a variety of cases. For example, in one of the leading cases from the Tax Court on the subject, a group of citizens, in conformity with the statutes of Indiana and Ohio, desiring to obtain electric service, constructed transmission lines and later transferred them to the taxpayer. The latter was required to maintain the lines and furnish electric current to those who had subscribed to the cost of constructing the line, as well as to other subscribers upon payment of the cost of equipment necessary to make connection with the line. The line became the property of the taxpayer-utility, upon being transferred by the constructor. The Tax Court held that the utility derived no income from the transaction. *Liberty Light & Power Company* v. *Commissioner,* 4 B. T. A. 155. See also *Texas and Pacific Railway Co.* v. *United States,* 52 F. (2d) 1040 (Ct. Cls. 1931), aff'd. 286 U. S. 285 (Spur tracks paid for by the users); *Kauai Railway Co.* v. *Commissioner,* 13 B. T. A. 686; *Chicago and Northwestern Railway Co.* v. *Commissioner,* 66 F. (2d) 61 (C. C. A. 7th), cert. den. 290 U. S. 672. Similarly it has been held that donations by municipalities or the members of a community to induce companies to locate their plant or factories at a particular place are not includible in recipient's income. *Holton & Company* v. *Commissioner,* 10 B. T. A. 1317; *Aransas Compress Co.* v. *Commissioner,* 8 B. T. A. 155; G. C. M.

16952, 1937-1 C. B. 133; See, also, *Kell* v. *Commissioner,* 88 F. (2d) 453 (C. C. A. 5th) (1937) and *Detroit Edison Co.* v. *Comm.,* 45 B. T. A. 358, aff'd by Circuit Court of Appeals for the Sixth Circuit, 1942 C. C. H. par. 9778. In Harvey, "Some Indicia of Capital Transfers Under the Federal Income Tax Laws," 37 Mich. L. Rev. 745 (1939), the author correctly summarizes the applicable principles by saying:

> "where money or property has been contributed to a business enterprise by stockholders or others with the intention that these funds are to be used as a part of the permanent capital structure of the company, a capital transfer has occurred out of which no taxable income arises. Similarly, any reimbursement or compensation for capital losses, whether there exists a legal obligaton to pay or not, may also be regarded as a transfer of capital out of which no taxable income arises."

Furthermore, it should be noted that in the instant case it is shown that the amounts paid by petitioner in improving and conserving said lands exceeded the amounts received by it as reimbursements by the United States Government. (R. 28, 31) Consequently, the payments received by petitioner could not be considered as taxable income, for under the classic definition in *Eisner* v. *Macomber,* 252 U. S. 189, income is the *gain* derived from capital, from labor, or from both combined.

It will be observed that the Regulations of the Department of Agriculture (Fed. Reg. Vol. 2, No. 38) do not permit payments under the Soil Conservation and Domestic Allotment Act to be made for improvements on lands owned by the United States. This is because under Sec. 10 of the Taylor Grazing Act (Act of June 28, 1934, 48 Stat. 1269, as amended by the Act of June 26, 1936, 49 Stat. 1976) a certain percentage of the rent paid under grazing leases is made available "for expenditure by the Secretary of the Interior for the construction, purchase, or maintenance of range improvements." Such improvements on leased range land are contracted for and paid for by the Government. So far as a Taylor Grazing Act lessee (such as petitioner) is concerned,

the result is the same as in the case of improvements on other lands made under the Soil Conservation and Domestic Allotment Act; in each case the cost is paid for by the Government; in each case the lessee receives some benefit from the range improvements; in each case soil conservation and the general public welfare is promoted. No one would suggest charging a lessee with an income tax on the value of improvements made by the United States on lands leased under the Taylor Grazing Act! Is there any more reason why the same lessee should be charged with an income tax on money received as a reimbursement of expenditures for like improvements on adjacent lands owned or leased by him from a State?

There is still another point. A citizen ought not to be charged with an income tax on money received from the United States in reimbursement of expenditures for rehabilitating lands in respect of which the United States admits responsibility for the conditions which necessitate the rehabilitation work. House Report No. 528 (Appendix "B" hereto) makes it clear that the Government's responsibility for the eroded condition of lands was fully recognized by Congress. It was there said:

> "Over tremendous areas, land destruction has proceeded to the point where it would be impossible to persuade or force the owners to assume the entire burden of control, nor would it be just to do so. Fundamentally, they have not been responsible for the erosion which has occurred. In the disposal of the public domain, settlers were encouraged to acquire the public lands and to cultivate them. With the transfer of ownership went no restrictions, instructions, or advice as to methods under which the land should be used in order to protect it from erosion.
>
> Acting in good faith, the settlers used their land in the light of the best information available. Since it was not the initial fault of the settler that his land became subject to erosion, it would not be right to require him to bear the entire burden of repairing damage done or of preventing future damage. Furthermore, the inter-

est of the Nation in controlling erosion far exceeds that of the private landowner."

3. *No case cited by the Tax Court serves to invalidate the contentions of petitioner in this case.*

The line of cases cited by the Tax Court as indicating that the doctrine of *Edwards* v. *Cuba Railroad Co.* has been "sparingly applied" may indeed indicate that fact, but none go so far as to hold that such doctrine does not apply where the material facts are the same. They do not indicate that the doctrine should not be applied here. On the contrary, it is petitioner's belief that those very cases have served to clarify the position of the Supreme Court in the *Cuba Railroad* case to such an extent that *they make it all the more apparent* why the instant case falls within the rule.

For example, in the case of *Texas and Pacific Ry. Co.* v. *U. S.*, 72 Ct. Cls. 629, 52 F. (2d) 1040, aff'd 286 U. S. 285, there is present a factual situation ideally suited to the necessary distinction. The *Cuba Railroad* rule was applied as to one angle of the case and denied as to another.

(a) The railroad, at the request of and for the benefit of, various persons along its right of way had constructed spur tracks, side tracks, culverts, etc. For all of this expenditure, the railroad was reimbursed by the persons so requesting and benefiting by the same. The Court of Claims found no difficulty in applying the rule contended for by petitioner in the present case and held the amounts so paid not to be income.

(b) Under another phase of the case, however, the railroad company contested the taxability of certain "guaranty payments" made to it by the U. S. Government under the provisions of Sec. 209 of the Transportation Act of 1920, 41 Stat. 464; 49 U. S. C. A. Sec. 77. Under the terms of that Act the United States guaranteed that, with respect to any carrier accepting the provisions of the Act, the "railway *operating income* of

such carrier for the guaranty period as a whole shall not be less'' than certain determined amounts. If the carrier's operating income fell below the determined figure, the Government paid the difference to the carrier. The railroad had accepted the terms of the Act and had received such payments from the Government in the sum of $2,043,041.77. These payments were made in order to bring the railroad's *operating income* to the specified figure. They were, as the Government contended, payments ''derived because of the operation of a railroad and consequently come within the definition of income as 'gain derived from capital, from labor, or from both combined.' '' See statement of Government's position, 285 U. S. 287. The Court of Claims so held, being unable to overlook ''the fact that it was *railway operating income* which was guaranteed and made up.'' 52 F. (2d) 1044. The railroad's contention that the *Cuba Railroad* case should be controlling was correctly overruled since these payments could in no sense be considered a reimbursement of capital expenditures or as a contribution to capital. Nor could the payments be considered a gift, since the railroad had also obligated itself under the terms of the Act to pay *to the Government* any excess over a specified operating income. The Supreme Court affirmed on this point, saying at page 289 of 286 U. S.:

''The purpose of the guaranty provision was to stabilize the credit position of the roads by assuring them a minimum operating income. They were bound to operate their properties in order to avail themselves of the Government's proffer. Under the terms of the statute *no sum could be received save as a result of operation.* If the fruits of the employment of a road's capital and labor should fall below a fixed minimum then the Government agreed to make up the deficiency, and if the income were to exceed that minimum the carrier bound itself to pay the excess into the federal treasury. In the latter event the carrier unquestionably would have been obligated to pay income tax measured by ac-

> tual earnings; in the former, it ought not to be in a better position than if it had earned the specified minimum. *Clearly, then, the amount paid to bring the yield from operation up to the required minimum was as much income from operation as were the railroad's receipts from fares and charges.''* (Italics supplied)

The cases of *Continental Tie and Lumber Co.* v. *United States,* 286 U. S. 290, and *Gulf Mobile & Northern Railroad Co.,* 22 B. T. A. 233, aff'd 293 U. S. 295, involve the identical question disposed of in the *Texas & Pacific Ry. Co.,* case, *supra,* and were decided in the same way on the same grounds.

Thus, it is clear that these three cases have no bearing on the instant case. They involve contributions by the sovereign to the income of the taxpayer; the payments were in effect but a substitution for the railroad's receipts from fares and like charges. Naturally such payments must be considered as income.

In the present case, the situation is entirely different. The payments received from the Government have no relation whatever to the operating income of the petitioner. There was no attempt or purpose on the part of the Government to maintain the ranch's income at a specified figure. As in the *Cuba Railroad* case, the payments were purely and simply a reimbursement for capital expenditures made by petitioner. The construction work done by petitioner in respect of which the payments were made was undoubtedly a capital improvement. Indeed petitioner does not understand that there is any contention to the contrary in this regard.

In the case of *Kansas City Southern Ry. Co.* v. *Commissioner,* 52 F. (2d) 372, cert. den. 284 U. S. 676, the Commissioner contended that the amounts paid to railroads as just compensation for the use of their properties during the period of Federal control was taxable income. The court upheld the contention. Again it is submitted that such a holding has no bearing on the instant case. The payments by the Government were no more than a substitution for the

customary *income* which the railroad would have received in performing its services as a carrier had it not been taken over by the Government for temporary use. Such payment for use was income just as much so as if rental had been paid for the use of the road by a private concern under lease. No capital assets were taken, nor was there a reimbursement for capital expenditures as there clearly was here.

In *Burke-Divide Oil Co.* v. *Neal,* 73 Fed. (2d) 857, a boundary dispute had occurred between Texas and Oklahoma as to which state included within its borders certain oil and gas claims. These claims had been located in good faith by the taxpayer in the bed of the Red River, the boundary line of the two states. The Supreme Court took jurisdiction of the dispute and appointed a receiver who took possession of the wells which had been located by the taxpayer, and under order of court *operated the properties and impounded the proceeds.* The dispute was settled in favor of the United States which had intervened, and an Act of Congress was passed to adjust the equitable claims of the locators. Under authority of said Act the Secretary of Interior paid to the taxpayer its share of the receiver's *operating income* attributable to the properties located by taxpayer. Clearly, such sums were income, and it was so held; but again there seems to be no relation between such a situation and this case, involving, as it does, the question of capital reimbursement.

The case of *Obispo Oil Co.* v. *Welch,* 85 F. (2d) 860, on this point merely follows the *Burke Divide Oil Co.* case, *supra.*

Marine Transport Co. v. *Commissioner,* 77 F. (2d) 177, contains nothing in opposition to petitioner's contentions in this case. There the taxpayer's schooner and cargo had been destroyed by a German submarine. In its 1917 return taxpayer took and was allowed a deduction for the full value thereof. In 1928, however, the Mixed Claims Commission awarded the taxpayer the full market value of the schooner and cargo, and taxpayer claimed that the amount so received

did not constitute income to it. It was held, however, that the sum so received was includible in full in its 1928 return. The holding was based on the recognized principle that what one receives for his property, in excess of its cost, is income, and that since taxpayer had recovered the cost of the schooner and cargo by the deduction taken in 1917, the amount received in 1928 must be deemed income. In the instant case, however, petitioner was not even reimbursed the amount of its cost in building the desired projects. Thus the *Marine Transport* case hardly seems applicable even by analogy.

The case of *Helvering* v. *Claiborne-Annapolis Ferry Co.*, 93 F. (2d) 875, resembles the *Texas & Pacific Ry. Co.* case, *supra*. The monthly payments made by the State of Maryland to the ferry company were paid by the state in consideration of the *maintenance* of the ferry, and, in the words of the court, "was as truly earned by the operation of that enterprise as were the tolls collected from vehicles and passengers." It certainly cannot be said that the payments made to petitioner by the U. S. Government were as truly earned in the operation of the ranch as were the amounts received by it from sales of its livestock. Unlike the present case, the ferry company used the money paid to it by the State for operating expenses and the accumulation of a dividend fund, just as it did with all other income. The amounts were thus clearly income as distinguished from the contribution to capital made in this case.

The last case cited by the Tax Court on this angle of the case is *Lykes Bros. S. S. Co.* v. *Commissioner,* 126 F. (2d) 725. In that case the steamship company received sums from the United States under a mail carriage contract. The payments were held to be income. Clearly the sums received for carrying mail were just as much income to the steamship company as the sums received by it for carrying passengers or other cargo. An analogous situation could be imagined in the present case. Suppose, for example, petitioner had been under contract with the U. S. Government to raise and deliver to it 1000 head of cattle. The

sum paid for the cattle admittedly would be income just as much so as amounts received from the sale to petitioner's regular customers. This hypothetical case, of course, differs widely from the actual facts. In reality all that petitioner did was to build a series of capital structures. For its expenditures so made it was reimbursed by the Government.

The Tax Court also appears to have overlooked the fact that the Government, at its own direct expense, has gone forward for many years with a program of range improvements with the object of range building and erosion control. Suppose the Department of Interior had erected the same water tanks, etc., on petitioner's lands, under its appropriation for range building or erosion control.* Would the Tax Court hold that the value of such improvements constituted income to petitioner? Or suppose the structures were erected by the Civilian Conservation Corps (as has been the case in some instances). Would the value of such structures be income to petitioner? What difference, in principle, can it make whether range building projects erected on private or leased lands are carried out by public agencies, or, as in this case, are simply induced or brought about by a payment to the land owner or lessee to reimburse him for the cost of such projects?

4. *It was error to hold that the payments here involved are taxable on the assumption that wholly different classes of payments under the same act may be taxable.*

In discussing the status of the payments made to the petitioner in this case, the Tax Court cites *Salvage* v. *Commissioner,* 76 Fed. (2d) 112 (C. C. A., 2d) (1935), as a case to be compared with the present one. That case involved the question of the correct cost basis to be used in the computation of gain on the sale of certain stock, which had been acquired by the taxpayer from the issuing corporation under a contract (1) that the issuing corporation

*See Secs. 2 and 10 of Taylor Grazing Act, as amended, Act of June 29, 1934 (48 Stat. 1269), Title 43, Secs. 315a and 315i, U. S. C. A.

should have an option to repurchase specified amounts of the stock at specified intervals and (2) that the taxpayer would not engage at any time throughout his life in any competing business without the corporation's consent. It is difficult to see how that case can even be compared with the present one, unless it be assumed that the Tax Court intended to derive some comfort from the following statement made by the Court in the course of its opinion:

> "The contract under which the petitioner purchased the 1500 shares of Viscose stock stated that the consideration for selling it at less than its real value was the petitioner's covenant relating to the option and to his refraining from engaging in any competing business. Compensation paid for refraining from labor would seem to be taxable income no less than compensation for services to be performed. *For example, a farmer who is paid for voluntarily refraining from raising hogs receives, in our opinion, income.* Certainly, it is neither a capital payment nor a gift." (Itailcs supplied.)

It may well be that the *obiter* expression of opinion by the Circuit Court, above quoted, to the effect that a farmer who is paid for voluntarily refraining from raising hogs receives income, caused the Tax Court to fall into the error of holding that the payments here involved are taxable income. It cannot be too strongly emphasized that this case is solely concerned with one class of payments under the Soil Conservation and Domestic Allotment Act. Whether other classes of payments are taxable is not involved and can have no bearing on the issue in this case. Only a few lines before its citation of the *Salvage* case, the Tax Court states that the payments in question—

> "were made under the same law and regulation that payments were made for refraining from raising cotton, or sugar beets, for devoting a portion of the acreage to the raising of leguminous crops, taking steps to eradicate rodents and noxious weeds, furrowing on the contour, withholding land from grazing, or following out other approved practices for building up the soil and preventing erosion."

However, there is no attempt to follow up this statement by a showing that the payments to the petitioner were in the same class as those referred to in the quotation. Clearly, they were not. The construction of reservoirs, dams, fences, and the digging of wells is obviously construction of a capital nature. It is needless to cite authority to the effect that the sale or exchange of such type of construction would fall within the provisions of the taxing statutes relating to gain or loss on the sale or exchange of "capital assets." See Sec. 117(a), I. R. C.; *Detroit Edison Co.* v. *Comm., supra.* Clearly, there is no relation between such activity and that type referred to in the Tax Court's quotation set forth above. Nothing in this case calls for a decision as to the taxability of such other classes of payments. Some or all of them may be taxable. Perhaps payments made as a substitute for normal *income* or to offset loss of *income,* resulting from compliance with the Government's wishes as to what crops to plant, or as to operating practices, could be construed to be taxable income, on some such theory as that applied in *Helvering* v. *Claiborne-Annapolis Ferry Company, supra,* where payments were held to be taxable, since they related to "the operation of the enterprise." The present case, however, must be decided on its own facts and without regard to how other classes of payments made under the same act should be treated for tax purposes.

IV. It was error to support the Tax Court's conclusion by considering the effect of an uncontested depreciation deduction in respect of the range improvements.

This case raises no issue as to petitioner's right to depreciation on the range improvements, and the decision here should not be influenced by what may or may not have been a correct allowance of depreciation in respect thereto. See *Detroit Edison Co.* v. *Comm., supra.*

At page 11 of the opinion the Tax Court attempts to bolster up its decision by referring to the fact that depreciation has been claimed and allowed on the investment in the

range projects here in question. The problem here is the single one of determining the taxable character of the payments. What depreciation is allowable is an issue entirely separate and to be decided, when properly raised, in the light of the final answer in the instant proceeding.*

V. The grants may be construed to be gifts to petitioner, and therefore exempt from taxation under Sec. 22(b)(3).

Sec. 22(b)(3) specifically excludes from gross income and exempts from taxation—

"the value of property acquired by gift."

Considering the provisions of the statutes authorizing the grants, it may be argued that they should be construed as gifts to the recipient. Sec. 7(a) of the Soil Conservation and Domestic Allotment Act provides that the powers of the Secretary "shall be used to assist *voluntary* action calculated to effectuate the purposes specified in this section." Sec. 8 (a) provides that in carrying out the provisions of the Act the Secretary "shall not have power to enter into any contract binding upon any producer or to acquire any land or any right or interest therein." This section also speaks of "payments or grants."

United States v. *Hurst,* 2 F. (2d) 73, lends support to this theory. That was a suit by the United States to recover an income tax in respect of the price received by the taxpayer upon the sale of certain petroleum mineral rights, which rights had been secured from the United States pursuant to the mineral laws. The court held that the grant of such rights by the Government to the taxpayer constituted a non-taxable gift. In so holding the court said:

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* At page 11 the Tax Court apparently inadvertently states, "If the amounts received from the Government are not included in income, it, in effect, will have a double deduction". No issue of a *deduction* from income is here involved. The sole issue is whether the payments are *includible* in taxable gross income. Depreciation is allowed in respect of property acquired by gift [I. R. C., Secs. 114(a), 113(b) and 113(a)(2)], but nonetheless gifts are not thereby established to be income; and no double deduction results from excluding gifts from income and at the same time allowing depreciation thereon.

> "Reward in some form or other is frequently the basis of a gift, as in the case of Barnes v. Poirier, supra, the court recognized the grant to be in the nature of a gift to old soldiers as compensation for past services to their government. If there could be a reward offered to old soldiers for past services to the government, upon the same theory why cannot a reward be offered to a discoverer of mineral deposits? *The result of the endeavor in each case is a benefit to the nation.*" (Italics supplied.)

Just so in the case at bar, "the result of the endeavor," under the range conservation programs is a lasting "benefit to the nation," and the Government's reimbursements therefor may well be considered as in the nature of a nontaxable gift. Cf. *Obispo Oil Co.* v. *Welch, supra,* in which this Court interpreted the *Cuba Railroad* case as being "an example of a pure gift."

CONCLUSION.

For the reasons heretofore stated, the payments or grants received by petitioner in 1937 and 1938 from the United States, pursuant to the Soil Conservation and Domestic Allotment Act, do not constitute taxable income. The decision of the Tax Court should be reversed and the case remanded with directions to the Court below to redetermine petitioner's taxes for said years by excluding the amounts of said payments or grants from net income.

Respectfully submitted,

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APPENDIX "A"

EXCERPTS FROM THE SOIL CONSERVATION AND DOMESTIC ALLOTMENT ACT, AS AMENDED.

The Act of April 27, 1935, Public No. 46—74th Congress (49 Stat. 163) provides in part as follows—

"AN ACT

To provide for the protection of land resources against soil erosion, and for other purposes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress Assembled, That it is hereby recognized that the wastage of soil and moisture resources on farm, grazing, and forest lands of the Nation, resulting from soil erosion, is a menace to the national welfare and that it is hereby declared to be the policy of Congress to provide permanently for the control and prevention of soil erosion and thereby to preserve natural resources, control floods, prevent impairment of reservoirs, and maintain the navigability of rivers and harbors, protect public health, public lands and relieve unemployment, and the Secretary of Agriculture, from now on, shall coordinate and direct all activities with relation to soil erosion and in order to effectuate this policy is hereby authorized, from time to time—

* * * * * * * * *

(3) To cooperate or enter into agreements with, or to furnish financial or other aid to, any agency, governmental or otherwise, or any person, subject to such conditions as he may deem necessary, for the purposes of this Act; and * * *."

The Act of February 29, 1936, Public No. 461—74th Congress (49 Stat. 1151) added ten new sections to the Act approved April 27, 1935, including the following provisions—

"Sec. 7. (a) It is hereby declared to be the policy of this Act also to secure, and the purposes of this Act shall also include, (1) preservation and improvements

of soil fertility; (2) promotion of the economic use and conservation of land; (3) diminution of exploitation and wasteful and unscientific use of national soil resources; (4) the protection of rivers and harbors against the results of soil erosion in aid of maintaining the navigability of waters and water courses and in aid of flood control; and (5) reestablishment, at as rapid a rate as the Secretary of Agriculture determines to be practicable and in the general public interest, of the ratio between the purchasing power of the net income per person on farms and that of the income per person not on farms that prevailed during the five-year period August 1909-July 1914, inclusive, as determined from statistics available in the United States Department of Agriculture, and the maintenance of such ratio. The powers conferred under sections 7 to 14, inclusive, of this Act shall be used to assist voluntary action calculated to effectuate the purposes specified in this section.

* * * * * * * * *

Sec. 8.

* * * * * * * * *

(b) Subject to the limitations provided in subsection (a) of this section, the Secretary shall have power to carry out the purposes specified in clauses (1), (2), (3), and (4) of section 7 (a) by making payments or grants of other aid to agricultural producers, including tenants and share-croppers, in amounts, determined by the Secretary to be fair and reasonable in connection with the effectuation of such purposes during the year with respect to which such payments or grants are made, and measured by, (1) their treatment or use of their land, or a part thereof, for soil restoration, soil conservation, or the prevention of erosion, (2) changes in the use of their land, * * * In determining the amount of any payment or grant measured by (1) or (2) the Secretary shall take into consideration the productivity of the land affected by the farming practices adopted during the year with respect to which such payment is made. * * * In carrying out the provisions of this section, the Secretary shall not have power to enter into any contract binding upon any producer or to acquire any land or any right or

interest therein. In carrying out the provisions of this section, the Secretary shall, in every practicable manner, protect the interests of small producers. The Secretary in administering this section shall in every practical way encourage and provide for soil conserving and soil rebuilding practices rather than the growing of soil depleting commercial crops.

(c) Any payment or grant of aid made under subsection (b) shall be conditioned upon the utilization of the land, with respect to which such payment is made, in conformity with farming practices which the Secretary finds tend to effectuate the purposes specified in clause (1), (2), (3), or (4) of section 7(a)."

APPENDIX "B"

Legislative History of the Soil Conservation and Domestic Allotment Act, As Amended

The Act of April 27, 1935 was originally introduced as H. R. 7054. House Report No. 528, 74th Congress, 1st Session, to accompany H. R. 7054 explained the general purpose of the Bill as follows:

"Explanation of the Bill

The preamble, section 1, sets forth the objectives of the bill, outlines the basis for a Federal policy of erosion control, and provides that the Secretary of Agriculture shall direct and coordinate all Federal activities with relation to soil erosion. Unless soil erosion can be controlled on farm, grazing, and forest lands, the prosperity of the United States cannot be permanently maintained. Control of erosion is essential to prevent the wastage of soil, conserve water, control floods, prevent the silting of reservoirs, maintain the navigability of rivers and harbors, protect public lands, and to keep from Federal relief rolls the populations of regions threatened with abandonment. These aspects of the problem justify Federal responsibility for the carrying out a national erosion control program.

* * * * * * * * *

Subsection (3) of section I authorizes agreements with, and financial or other aid to, any agency or any person, insofar as may be required for the purpose of

controlling erosion. The agreements or aid would be subject to such conditions as may be deemed necessary and as are authorized by the act.

The aid authorized in this subsection will be necessary because, in general, the owner of private lands cannot bear the entire cost of controlling the erosion thereon. He has neither the technical knowledge nor the financial resources. Over tremendous areas, land destruction has proceeded to the point where it would be impossible to persuade or force the owners to assume the entire burden of control, nor would it be just to do so. Fundamentally, they have not been responsible for the erosion which has occurred. In the disposal of the public domain, settlers were encouraged to acquire the public lands and to cultivate them. With the transfer of ownership went no restrictions, instructions, or advice as to methods under which the land should be used in order to protect it from erosion.

Acting in good faith, the settlers used their land in the light of the best information available. Since it was not the initial fault of the settler that his land became subject to erosion, it would not be right to require him to bear the entire burden of repairing damage done or of preventing future damage. Furthermore, the interest of the Nation in controlling erosion far exceeds that of the private landowner. An individual may destroy his land, move away, obtain a position somewhere else, accumulate capital, and purchase new land. For the Nation, land destroyed is land gone forever. This drain on the national resource is not immediately fatal, but, if the destruction continues unchecked, the time will come when remaining land resources will be insufficient to support our population on an adequate standard of living. The cost to the Nation of such changes would be incalculable. Moreover, erosion directly threatens vast Federal investments in dams and channels and annually requires the expenditure of large sums for dredging operations. The only practical method of eliminating these hazards and costs is to control the erosion on private lands, and it would not be equitable to require the owner of these lands to make expenditures for the protection of Federal investments."

Senate Report No. 466, 74th Congress, 1st Session, to accompany H. R. 7054, explained the general purposes of the Bill, as follows:

"Explanation of the Bill.

Recognizing that, unless soil erosion can be controlled on farm, grazing, and forest lands, the prosperity of the United States cannot be permanently maintained, the bill provides for the coordination of all Federal activities with relation to soil erosion.

Heretofore, soil-erosion control has been among several groups in the different Departments. The present bill coordinates all of these groups and places the control under the Secretary of Agriculture. Experiences of recent storms, both flood and wind, demonstrate the necessity to prevent wastage of soil, the conservation of water, and the control of floods. The silting of reservoirs, the maintaining of the navigability of rivers and harbors, the protection of public lands, all justify Federal responsibility for the carrying out of a national erosion-control program."

The Senate Report then set forth almost verbatim the above explanatory provisions set forth in House Report No. 528.

The amendments to the Act of April 27, 1935 which were finally enacted in the Act of February 29, 1936, were first considered in the House of Representatives in connection with H. R. 10835, 74th Congress, 2nd Session. House Report No. 1973, 74th Congress, 2nd Session, to accompany H. R. 10835 and entitled "Soil Conservation Act" states:

"The bill recognizes that the agricultural problem is one demanding national attention. No one can doubt that the prosperity of our vast farming population is a matter of national concern. Nor can it be questioned that the depletion of our soil resources is a menace to our present and future well-being as a nation. If means can be found to rehabilitate the agricultural industry by methods not in conflict with the Constitution the national welfare will be promoted. This bill proposes to meet the agricultural problem by the exercise of Federal powers, in conformity with the Constitution, through provision for conserving our soil resources and for making proper utilization of them.

The methods proposed by the bill to accomplish its purpose are twofold. First, the bill provides for grants to States to enable them to carry out their own programs for agriculture rehabilitation. Second, the bill provides for conditional noncoercive payments by the Federal Government to farmers to encourage proper utilization of their soil until such time as State action can become operative.

Necessity for Soil Conservation

We have been forced in recent years to regard the rapid depletion of our soil as a menace to national welfare. * * * The consequences in exhaustion of our soil resources have not been so readily apparent. But the recent dust storms and the presence of large areas of eroded lands point to the desirability, from an immediate as well as a long-range point of view, of the national objective of saving our land. The necessity for such a policy was set forth by the President in his message to Congress of June 8, 1934 (H. Doc. 397, 73d Cong., 2d sess.), in which he stated:

> 'The extent of the usefulness of our great natural inheritance of land and water depends on our mastery of it. We are now so organized that science and invention have given us the means of more extensive and effective attacks upon the problems of nature than ever before. We have learned to utilize water power, to reclaim deserts, to re-create forests and to redirect the flow of population. Until recently we have proceeded almost at random, making many mistakes.
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> There are many illustrations of the necessity for such planning. Some sections of the Northwest and Southwest, which formerly existed as grazing land, were spread over with a fair crop of grass. On this land the water table lay a dozen or 20 feet below the surface, and newly arrived settlers put this land under the plow. Wheat was grown by dry-farming methods. But in many of these places today the water table under the land has dropped to 50 or 60 feet below the surface and the top soil in dry seasons is blown away like driven snow. Falling rain, in the absence of grass roots, filters through the soil, runs off the surface, or is quickly reabsorbed into the at-

mosphere. Many million acres of such land must be restored to grass or trees if we are to prevent a new and man-made Sahara.

At the other extreme, there are regions originally arid, which have been generously irrigated by human engineering. But in some of these places the hungry soil has not only absorbed the water necessary to produce magnificent crops, but so much more water that the water table has now risen to the point of saturation, thereby threatening the future crops upon which many families depend. (Page 3.)'

The Department of Agriculture estimated in 1934 that 50,000,000 acres of farm land had been destroyed because the soil had been allowed to wash away, and that another 50,000,000 acres were in almost equally bad condition. The Department further estimated that an additional 100,000,000 acres of land had been seriously impaired by erosion and that erosion had begun upon still another 100,000,000 acres. Studies have indicated that deterioration threatens the great bulk of 360,000,000 acres of cultivated lands in the United States, and if permitted to continue unchecked will lead to a steady increase in costs of production of foods and fibers on American farms, with consequent increased outlays by consumers for farm products and reduced net incomes to producers. Studies also show that such deterioration of national soil resources could be prevented by the general adoption of appropriate farming practices and that the cost of general adoption of such practices would be small compared with the cost of efforts to correct the results of failure to do so.

This bill proposes to encourage the adoption of such practices and thereby promote the general welfare in a fundamentally national sense by removing impediments to the preservation of the quality of the national soil resources, * * *.

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Federal Payments to Farmers for Land Conservation

The bill also adds a new section (sec. 8) to the Soil Erosion Act. This section is temporary in its operation. By its terms the Secretary of Agriculture is

given power to make payments or other grants of aid to agricultural producers to encourage farming practices designed to result in (1) preservation and improvement of soil fertility, (2) promotion of the economic use of land, and (3) diminution of exploitation and unprofitable use of national soil resources. He is given no independent power, under the temporary plan, to provide for a continuous and stable supply of agricultural commodities or to provide for reestablishing and maintaining farm purchasing power. Such payments or grants are to be conditioned upon such utilization of land as the Secretary finds has tended to accomplish the purposes enumerated above. The amount to be paid to each producer for carrying out soil-conservation practices is to be based upon the treatment or use of land for soil restoration, soil conservation, or the prevention of erosion, as the case may be; changes in the use of land; or a domestic allotment percentage. The Secretary is to take into consideration the productivity of the land affected in making any payment based upon land use.

The Secretary is expressly denied the power to enter into contracts binding any producer to any course of action or to acquire any land or right or interest in land uder the bill.

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Under the temporary plan, each producer is completely free to do as he pleases with his farm. There is no coercion upon him to change his practices, to adopt any particular practice, or to fail to adopt any practice. Not only has the farmer freedom of choice, but the Secretary of Agriculture is expressly forbidden to bind him in any choice. The Secretary is expressly prohibited from entering into any contract binding upon a producer or to acquire any land of the producer or any right or interest in the land of the producer. No obligation is to be assumed by the farmer as consideration for any payment or grant of aid. No requirement is imposed upon a farmer, even if he wants to have it imposed upon him, to enter upon any course of action, and no civil or penal consequences are enforceable with respect to him out of his failure to act or his having acted in any way. Thus, as a direct exercise of Federal power the temporary plan is wholly within the Constitution under the Butler decision.''

The Bill as introduced in the Senate was known as S. 3780, 74th Congress, 2nd Session. Senate Report No. 1481, 74th Congress, 2nd Session to accompany S. 3780, entitled "Conservation and Utilization of the Soil Resources" stated:

> "The stated purpose of the pending bill is entirely different from that contained in the Agricultural Adjustment Administration Act. The provisions of the bill are entirely different. No contracts to comply with Federal regulations or contracts of any sort are provided for. The conservation of natural resources, the fertility of agricultural lands, and soil building are the declared purposes of the pending bill. No tax is levied by the bill. The fact that prevailing farm practices are depleting soil fertility and will, if continued, ultimately endanger a steady supply of necessary foods and raw material for clothing is a matter of common knowledge. The fact that such practices will continue to increase the cost of production and, therefore, the prices to be paid by the people is a matter of national interest. Economic production of agricultural products is a matter which directly affects the price paid by all consumers and is one that directly affects the general welfare.
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> The bill proposes to amend Public No. 46, Seventy-fourth Congress, which made provisions for prevention of erosion, by bringing within its policy and purposes, the improvement and preservation of national soil resoures. It expresses a purpose to effect this result through encouragement of the use of these resources in such manner as to preserve and improve fertility, promote economic use, and diminish the exploitation and unprofitable use of national soil resources.
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> Thus the bill lays out a plan for an ordered program designed to encourage sound soil-conservation practices without thereby diminishing farmers' incomes or causing undue curtailment of supplies of agricultural commodities.
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In Conference Report No. 2079, 74th Congress, 2nd Session, to accompany S. 3780, the report being entitled "Soil Conservation and Domestic Allotment Act", there is further discussion of minor changes made in the bill as originally introduced in order to more clearly and fully set forth the purposes of the legislation.